NO. 48893-1-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

HEARTLAND EMPLOYMENT SERVICES, LLC,

Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Respondent.

BRIEF OF RESPONDENT

ROBERT W. FERGUSON
Attorney General

Kelly Owings
Assistant Attorney General
WSBA No. 44665
Cameron G. Comfort
Assistant Attorney General
WSBA No. 15188
7141 Cleanwater Drive SW
PO Box 40123
Olympia, WA 98504-0123
(360) 753-5528
OID No. 91027

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitutional Provisions

Statutes

Regulations

I. INTRODUCTION

Appellant Heartland Employment Services, LLC seeks to avoid the broad application of the business and occupation (B&O) tax by claiming that it qualifies for a deduction allowed to professional employer organizations (PEOs). But to receive the benefit of that deduction, RCW 82.04.540 imposes two requirements. First, a taxpayer must have a written professional employer agreement that (a) establishes a coemployment relationship with a client and (b) allocates employer rights and obligations between the PEO and the PEO's client. Second, the employees must receive written notice of that coemployment relationship with a PEO and the PEO's client.

The undisputed, material facts in the record demonstrate that Heartland cannot satisfy these conditions. Heartland's Employee Leasing Agreement with its affiliates expressly identifies Heartland as the employer, and it allocates all employer rights and obligations to Heartland. Thus, it is not a written professional employer agreement as defined in RCW 82.04.540. The employees also did not receive written notice of coemployment with Heartland and the affiliates. None of the documents Heartland relies upon come close to describing a coemployment relationship between Heartland, the affiliates, and the employees.

Because its records are wholly inadequate, Heartland relies on its course of dealings with the affiliates to contradict what its documents expressly state. But the plain meaning of RCW 82.04.540 requires that the face of a written professional employer agreement and the written notice to employees of coemployment establish that a taxpayer is a PEO. Heartland may not use extrinsic evidence to qualify for the PEO deduction or to contradict the terms of its Employee Leasing Agreement. This Court should affirm the trial court's order granting summary judgment to respondent Department of Revenue, and denying summary judgment to Heartland.

II. STATEMENT OF ISSUE

PEOs are entitled to a deduction on certain gross income if they meet two conditions: (1) they have a written agreement that (a) establishes a coemployment relationship and (b) allocates employer rights and obligations between the PEO and the PEO's client; and (2) employees have received written notice of coemployment. Is Heartland ineligible for the PEO deduction, where its Employee Leasing Agreement allocates control in all aspects of the employment relationship to Heartland, and its employees did not receive written notice of a coemployment relationship?

III. STATEMENT OF THE CASE

A. Heartland's Employee Leasing Agreement With The Affiliates

HCR ManorCare, Inc. owns, either directly or indirectly, hundreds of companies, including Heartland, that are connected to the health care industry. CP at 11-15. Heartland is an Ohio limited liability company that provides employees to affiliated companies operating nursing and assisted living centers throughout the United States, including Washington. CP at 37, 108-15. Heartland's sole member is its parent company, HCR Healthcare, LLC. CP at 11, 32. HCR Healthcare is the registered owner of a service mark that contains the name "HCR ManorCare." CP at 36. Heartland and the affiliates use the HCR ManorCare service mark to refer to the companies HCR ManorCare, Inc. owns, including HCR Healthcare, Heartland, and other affiliated companies. CP at 34.

In Washington, Heartland provided employees to seven affiliated companies: Manor Care of Lacey WA, LLC; Manor Care of Salmon Creek WA, LLC; Manor Care of Gig Harbor WA, LLC; Manor Care of Lynnwood WA, LLC; Manor Care of Spokane WA, LLC; Manor Care of Tacoma WA, LLC, and In Home Health, LLC (Affiliates). CP at 158. All but one of the Affiliates operated in Washington using the trade name "ManorCare Health Services" or "ManorCare Health Services," followed by the name of the city where the Affiliate operated. CP at 550-593. In

Home Health used other trade names in its operations, including "Heartland Home Health Care," "Heartland Home Health Care (Home)," "Home Health Plus," and "In Home Health." CP at 551, 599. The Affiliates and Heartland did not register any other trade names for use in Washington. CP at 550-95, 599.

During the tax period, Heartland provided employees to the Affiliates pursuant to a written agreement entitled "Employee Leasing Agreement." CP at 37-115 (attached as Appendix A). The Employee Leasing Agreement refers to Heartland as "HES," the Affiliates as "Lessees," and the employees as "Personnel." CP at 37-40. Its purpose is clearly described: "the parties desire that HES [Heartland[1]] be a provider of select personnel . . . necessary to operate each Lessee in accordance with such Lessee's employee policies." CP at 37. The Agreement appoints Heartland as "a provider of Personnel to each Lessee on a daily basis, as required." CP at 37 (Section 1.01). Furthermore, Heartland shall "provide to each Lessee such Personnel as such Lessee shall deem necessary from time to time to operate such Lessee." CP at 37 (Section 1.01). The Agreement expressly declares that '[a]ll Personnel will be employees of [Heartland]." CP at 37 (Section 1.02).

[1] Throughout the remainder of this brief, all references in the Agreement to "HES" will be replaced with "[Heartland]."

Given that the Personnel are employees of Heartland under the Employee Leasing Agreement, Heartland is granted control in all employment matters. While the Affiliates "have the right to provide input in recruiting, hiring, evaluating, replacing and supervising Personnel provided by [Heartland] . . . [Heartland] shall retain ultimate direction and control over such matters." CP at 37-38 (Section 1.03). As part of its authority over these employment matters, Heartland "shall maintain the right of control and direction of the promulgation and administration of the Personnel employment policies." CP at 38 (Section 1.03). The Affiliates "shall cooperate with [Heartland] in the formation and implementation" of these policies. CP at 38 (Section 1.03). In contrast, the Affiliates may amend their "employee policies" at their "sole discretion." CP at 37 (Section 1.02). Heartland "shall have the right and responsibility to direct and control the Personnel consistent with each Lessee's employee policies." CP at 37 (Section 1.02).

Finally, the Employee Leasing Agreement requires Heartland to perform various other obligations as the employer. Heartland "shall comply with all federal, state and local employment laws and regulations." CP at 38 (Section 1.04). It is "responsible for the payment of all federal and state employment taxes with respect to the Personnel." CP at 38 (Section 1.05). For unemployment compensation, Heartland "shall be the

rated employer . . . with respect to the Personnel." CP at 38 (Section 1.07). Heartland also "shall carry or provide through self-insurance all appropriate workers' compensation insurance with respect to the Personnel." CP at 38 (Section 1.06).

In return for Heartland providing the employees, the Employee Leasing Agreement states that each Affiliate "shall pay an amount equal to the direct wage and compensation expenses incurred by [Heartland] to provide the services of the Personnel." CP at 39 (Section 3.01). According to the Agreement, these expenses include "all wages, salaries, bonuses, employer payroll taxes, employee benefit costs, administration expenses, and overhead expenses" that relate to the employees. CP at 39 (Section 3.01). In turn, Heartland must maintain sufficient records to allow the Affiliates "to allocate the cost of services provided . . . to the business units for which [Heartland] provides the Personnel." CP at 39 (Section 3.02). The Agreement declares that it contains "the entire understanding of the parties." CP at 40 (Section 7.04).[2]

B. Records Received By Employees Or Made Available To Employees

[2] Heartland's description of the Employee Leasing Agreement is markedly different than the Department's description above. *See* App. Br. at 3-4. This is because the Department describes the terms of the Agreement by relying on the express language in the Agreement. In contrast, Heartland mischaracterizes the terms of the Agreement by relying primarily on extrinsic evidence that directly contradicts the language in the Agreement. App. Br. at 3-4.

Once Heartland provided employees to the Affiliates, the employees received various documents relating to their employment. At the beginning of their employment, employees received an employee handbook. CP at 33. The cover of the employee handbook contains the HCR ManorCare service mark. CP at 116. The rest of the handbook constantly refers to HCR ManorCare in relation to various employment policies. *See, e.g.,* CP at 117 ("We, the employees of HCR ManorCare, are dedicated to providing the highest quality in health care services."), CP at 119 ("I am pleased that you have chosen to be part of the HCR ManorCare team."). The employee handbook specifically references Heartland. It states, "Most employees are employed by Heartland Employment Services, LLC, an employment company of HCR ManorCare." CP at 123.

At the start of their employment, employees also signed a document entitled "Letter of Understanding – Forty-Hour Work Week." CP at 329. The top of the letter contains HCR HealthCare's service mark with the "HCR ManorCare" name, while the bottom of the letter mentions HCR HealthCare as holding the copyright to the form. CP at 329. The body of the letter consists of several paragraphs with blanks to be filled in appropriately. CP at 329. It states, "I understand that as an employee of _____ (location name), I am working under the 40 hour work week described in the Fair Labor Standard Act (Part 778) as defined in the HCR

ManorCare overtime policy." CP at 329. The next paragraph in the letter provides "HCR ManorCare, through its employment company, Heartland Employment Services, LLC, is committed to paying its employees correctly and on-time. I, _____ (employee name), am an employee of HCR ManorCare and I acknowledge that if an error in my pay is made, HCR ManorCare has the right to make deductions from my pay to correct the error." CP at 329. Both the employee and the manager or human resources designee at the Affiliate sign the letter. CP at 329.

Employee paystubs contained three names: Heartland, the specific Affiliate where the employee worked, and the HCR ManorCare service mark. CP at 149-50.

Other documents available to employees during their employment also refer to Heartland as the employer. For example, employees are sent a monthly newsletter describing events that have occurred at various Affiliates. CP at 146-48. The newsletter includes the "HCR ManorCare" service mark and refers to HCR ManorCare at least a dozen times. CP at 146-48. The bottom of the newsletter, however, explains that the phrase "'HCR ManorCare employees' refers generally to employees of Heartland Employment Services." CP at 148.

C. The Department's Investigation Of Heartland

In 2012, the Department of Revenue learned that Heartland was reporting millions of dollars in wages to the Washington Employment Security Department. CP at 187. At the same time, Heartland was on active non-reporting filing status with the Department of Revenue. CP at 187. As an active non-reporter, Heartland admitted that it was conducting business in Washington, but claimed that it met certain criteria that allowed it not to file an excise tax return. *See* RCW 82.32.045(4) (describing when Department may place a taxpayer on active nonreporter status). Because of this inconsistency in reporting, the Department sent Heartland a letter asking it to complete a form describing its business activities. CP at 187, 190.

In response, Heartland completed the form and described itself as a PEO. CP at 187, 191. Heartland claimed to be an active nonreporter because its entire income from the Affiliates qualified for the PEO deduction under RCW 82.04.540. CP at 187, 191. Based on this claim, the Department conducted an audit to ensure that Heartland was accurately reporting its tax liabilities to Washington. CP at 187.

While Heartland claimed to the Department to be a PEO, the Department discovered that Heartland was not reporting wages and paying unemployment taxes to Employment Security as a PEO. CP at 204-36.

Instead, Heartland reported wages and paid taxes to Employment Security as the sole employer. CP at 204-36. The Affiliates also had neither separately registered with Employment Security as PEO clients, nor paid unemployment insurance taxes based on their own tax rates.[3] CP at 204. Notwithstanding its reporting to Employment Security, Heartland still insisted to the Department of Revenue it was a PEO entitled to RCW 82.04.540's deduction. CP at 191. After reviewing Heartland's records and reporting to Employment Security, the Department concluded that Heartland did not qualify for the PEO deduction and assessed against Heartland $2,050,526 in B&O taxes plus penalties and interest for the January 2009 through March 2013 tax period. CP at 187, 192-202.

Heartland then filed an action seeking a refund of $71,837 in B&O tax that it paid for a single month outside the tax period, claiming it met RCW 82.04.540's requirements for the PEO deduction. CP at 4-7. The parties filed cross-motions for summary judgment. CP at 654-55. After oral argument, the trial court granted summary judgment to the Department and denied summary judgment to Heartland. CP at 654-56.

[3] RCW 50.12.300(1) &(6) requires each PEO client to register separately with Employment Security and use its own assigned tax rate when paying unemployment taxes.

IV. ARGUMENT

This Court reviews appeals from a summary judgment order de novo. *Wash. Imaging Services, LLC v. Dep't of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011). Summary judgment is appropriate when there are no genuine issues of material fact and the moving party is entitled to summary judgment as a matter of law. *Id.* While this Court's review is de novo, Heartland bears the burden of proving that it qualifies for the PEO deduction under RCW 82.04.540 and is entitled to a refund. *Id.* (citing RCW 82.32.180).

This Court should affirm the trial court's summary judgment for the Department because Heartland fails to meet the straightforward requirements set forth in RCW 82.04.540 to qualify for the PEO deduction. The Legislature could not have been clearer: to qualify for the PEO deduction, a taxpayer must have a written professional employer agreement and employees must receive written notice of their coemployment. The records that Heartland relies upon in this appeal do not meet these requirements. Nor may Heartland use its course of dealings with the Affiliates to meet these requirements, when RCW 82.04.540 expressly requires a taxpayer's status as a PEO to be established *in writing* through a professional employer agreement and coemployment notice. Because Heartland's records do not establish that it is a PEO as the statute

requires, the trial court correctly concluded that Heartland, as a matter of law, cannot exclude its income from B&O taxation under RCW 82.04.540.

A. The Legislature Created A Limited Deduction From B&O Taxes For PEOs That Meet RCW 82.04.540's Documentation Requirements.

As the Supreme Court has recognized, "Washington's B&O tax system is extremely broad." *Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 896, 357 P.3d 59 (2015). Under this system, "the [L]egislature intended to impose the business and occupation tax upon virtually all business activities carried on within the state." *Id.* (internal quotations omitted). Accordingly, RCW 82.04.220 imposes the B&O tax upon every person "for the act or privilege of engaging in business activities." Consistent with this broad scope, the Legislature expansively defines the measure of the B&O tax through the application of various rates against the "gross income of the business." RCW 82.04.220(1). The "gross income of the business" means:

> [T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, *all without any deduction on account of* the cost of tangible property sold, the cost of materials used, *labor costs*, interest, discount, delivery costs, taxes, *or any other expense whatsoever paid or accrued* and without any deduction on account of losses.

RCW 82.04.080(1) (emphasis added). Thus, under RCW 82.04.080, the B&O tax applies to a taxpayer's entire gross income from engaging in business, without any deduction for the costs of doing business. In this case, Heartland is engaging in the business of providing employees to the Affiliates. Any amount that Heartland receives for providing such employees is part of Heartland's "gross income of the business" and generally is subject to the B&O tax. Likewise, Heartland may not deduct or exclude its expenses associated with paying its employees unless an exemption or deduction applies.

The deduction Heartland claims is provided by RCW 82.04.540. Under that statute, a PEO may deduct certain gross income that it has earned:

> A professional employer organization is allowed a deduction from the gross income of the business derived from performing professional employer services that is equal to the portion of the fee charged to a client that represents the actual cost of wages and salaries, benefits, workers' compensation, payroll taxes, withholding, or other assessments paid to or on behalf of a covered employee by the professional employer organization under a professional employer agreement.

RCW 82.04.540(2) (copy of complete statute attached as Appendix B). Heartland argues that RCW 82.04.540 applies to all the gross income that it earned from providing employees to the Affiliates. Heartland, however,

fails to meet the specific conditions that the Legislature set forth in the statute.

To qualify for the PEO deduction, Heartland must meet the statutory definition of a PEO, which includes several components. According to RCW 82.04.540(3)(f), a PEO is "any person engaged in the business of providing professional employer services." The statute further defines "professional employer services" as "the service of entering into a coemployment relationship with a client in which all or a majority of the employees providing services to a client or to a division or work unit of a client are covered employees." RCW 82.04.540(3)(g). A PEO and a client have a coemployment relationship with a "covered employee" when two conditions are met: (1) "the individual's coemployment relationship is pursuant to a professional employer agreement," and (2) "[t]he individual has received written notice of coemployment with the professional employer organization." RCW 82.04.540(3)(d)(i-ii).

Here, Heartland failed to establish the existence of a written professional employer agreement or that employees received written notice of coemployment with a PEO. Therefore, Heartland did not qualify for the PEO deduction, and this Court should affirm the trial court's order granting summary judgment to the Department.

B. Heartland Fails the First Element: Employees Do Not Have A Coemployment Relationship With Heartland And Affiliates Through A Written Professional Employer Agreement.

The PEO statute requires an employee to have a "coemployment relationship . . . pursuant to a professional employer agreement." RCW 82.04.540(3)(d)(i). The Legislature defines a "professional employer agreement" as a "*written contract* by and between a client and a professional employer organization." RCW 82.04.540(3)(e) (emphasis added). The written contract must provide for *both* "the coemployment of covered employees," and "the allocation of employer rights and obligations between the client and the professional employer organization with respect to covered employees." *Id.*

In applying RCW 82.04.540 to its own Employee Leasing Agreement with the Affiliates, Heartland ignores the statute's express language and much of the Agreement. Instead, Heartland emphasizes a few, select phrases from the Agreement to assert that the employees at issue have a coemployment relationship pursuant to a written professional employer agreement. The trial court correctly concluded, however, that the Agreement examined in its entirety does not meet RCW 82.04.540's definition of a professional employer agreement as a matter of law. *See Viking Bank v. Firgrove Commons 3, LLC*, 183 Wn. App. 706, 713, 334 P.3d 116 (2014) (to interpret a contract, courts should view the contract in

its entirety, considering particular language in the context of other provisions).

1. The Employee Leasing Agreement fails to allocate employer rights and obligations between Heartland and the Affiliates.

A written professional employer agreement must provide for "the allocation of employer rights and obligations between the client and the professional employer organization with respect to covered employees." RCW 82.04.540(3)(e)(ii). In the Department's view, this means that both the PEO and client must maintain the rights, duties, and obligations of an employer to a "material degree." CP at 284 (Department's Excise Tax Advisory, ETA 3192.2014 at 5 (Oct. 9, 2014)). Thus, a written professional employer agreement must do more than assign "nominal rights, duties, and obligations" to a client. CP at 284 (ETA 3192.2014 at 5). Otherwise, the requirement of allocation would be meaningless.[4] *G-P Gypsum Corp. v. Dep't of Revenue,* 169 Wn.2d 304, 309, 237 P.3d 256 (2010) (must give effect to all the language in a statute so that no part is rendered meaningless or superfluous).

[4] In contrast, Heartland's interpretation of RCW 82.04.540 renders the allocation requirement meaningless. Heartland argues that the statute does not require an agreement to allocate employer rights and obligations to one party or the other. App. Br. at 10. Thus, according to Heartland, an agreement would meet RCW 82.04.540's allocation requirement even if one party had no employer rights and obligations under the agreement, so long as the agreement clearly expressed this lack of allocation. This Court should reject such an interpretation because it fails to give full effect to the word "allocate" in the statute. *G-P Gypsum Corp.,* 169 Wn.2d at 309 (courts should give full effect to all the words in a statute).

Based on such allocation, a PEO "is subject to only those obligations specifically allocated to the professional employer organization by the professional employer agreement or applicable state law," and a client "is entitled to enforce those rights and obligated to provide and perform those employer obligations allocated to such client by the professional employer agreement and applicable state law." RCW 82.04.540(3)(c)(i-ii). For any right or obligation "not specifically allocated to the professional employer organization by the professional employer agreement or applicable state law," the client is entitled to enforce such right or obligation. RCW 82.04.540(3)(c)(iii).

Here, rather than allocating employer rights and obligations between Heartland and the Affiliates, the Employee Leasing Agreement expressly grants all employer rights and obligations to Heartland. For this reason, Heartland relies on its course of dealing with the Affiliates to establish a relationship at odds with that stated in the Agreement. This is improper, but even if this extrinsic evidence is considered, it fails to support Heartland's claim.

a. The Employee Leasing Agreement expressly grants all employer rights and obligations to Heartland.

Contrary to RCW 82.04.540's plain requirements, the Employee Leasing Agreement does not allocate employer rights and obligations

between Heartland and the Affiliates. Instead, it allocates all employer rights and obligations to Heartland. First, the Agreement assigns all administrative rights and obligations of an employer to Heartland. CP at 38. Heartland concedes this. App. Br. at 9. According to the Agreement, Heartland is responsible for handling federal and state employment taxes, workers' compensation insurance, unemployment compensation, and complying with all employment laws. CP at 38 (Sections 1.04-1.07) Thus, the Agreement allocates no administrative rights or obligations to the Affiliates.

Beyond administrative responsibilities, the Employee Leasing Agreement allocates to Heartland all other rights and obligations typically associated with an employer. According to the Agreement, Heartland is the "provider of Personnel," and "[a]ll Personnel will be employees of [Heartland]." CP at 37 (Sections 1.01-1.02). Consistent with its status as the employer, Heartland has "ultimate direction and control" over the "recruiting, hiring, evaluating, replacing and supervising" of the employees. CP at 37-38 (Section 1.03). As the employer, the Agreement also states that Heartland "shall have the right and responsibility to direct and control the Personnel consistent with each Lessee's employee policies." CP at 37 (Section 1.02). In relation to the employment policies for the personnel under the Agreement, Heartland "shall maintain the right

of control and direction of the promulgation and administration" of such policies." CP at 38 (Section 1.03). Taken together, these provisions demonstrate that Heartland is not merely the employer of record as Heartland argues. App. Br. at 3. Instead, the Agreement as a whole demonstrates that Heartland has the rights and obligations of the "functional employer" as well. *See Viking Bank*, 183 Wn. App. at 713 (courts should interpret contract as a whole).

Ignoring most of the Employee Leasing Agreement, Heartland relies on three "employer rights and obligations" that the Agreement allegedly allocates to the Affiliates. First, Heartland argues that under the Agreement, the Affiliates determine the number and type of personnel for operating a facility. App. Br. at 9. This is not what the Agreement says. The Agreement merely allows an Affiliate to request that Heartland provide it with an employee. *See* CP at 37 (Section 1.01 stating that Heartland "shall provide to each Lessee such Personnel as such Lessee shall deem necessary from time to time to operate such Lessee"). Once an Affiliate determines that an employee is necessary, Heartland still has "ultimate direction and control" over recruiting and hiring employees. CP at 37-38 (Section 1.03). Thus, while an Affiliate may ask Heartland for an employee, the Agreement does not grant an Affiliate the right make any determinations relating to hiring employees as Heartland contends.

Second, Heartland argues that each Affiliate is responsible for creating and amending employee policies. App. Br. at 9. To make this argument, Heartland isolates a single provision in the Employee Leasing Agreement rather than examining it as a whole. *See Viking Bank,* 183 Wn. App. 706, 713, 334 P.3d 116 (2014) (courts should "view the contract as a whole, interpreting particular language in the context of other provisions").

The Employee Leasing Agreement states that Heartland "shall have the right and responsibility to direct and control the Personnel consistent with each Lessee's employee policies, which any Lessee may amend from time to time at its sole discretion." CP at 37 (Section 1.02). The next section, however, makes it clear that under the Agreement, Heartland controls the employment policies related to the "Personnel," declaring that Heartland "shall maintain the right of control and direction of the promulgation and administration of the *Personnel employment policies*." CP at 38 (Section 1.03) (emphasis added). Because Heartland maintains this right of control and direction, the Agreement requires the Affiliates to "cooperate with [Heartland] in the formation and implementation of policies pertaining to the time and performance of duties by the Personnel." CP at 38 (Section 1.03). Thus, under the

Agreement, Heartland controls the employment policies for the personnel, not the Affiliates.

Third, Heartland contends that the Employee Leasing Agreement grants the Affiliates "rights with respect to 'recruiting, hiring, evaluating, replacing and supervising employees.'" App. Br. at 9. Heartland's argument contradicts the specific language in the Agreement that allegedly provides the Affiliates with such rights. Section 1.03 only states that the Affiliates "shall have the right *to provide input* in recruiting, hiring, evaluating, replacing and supervising Personnel" that Heartland provides. CP at 37-38 (Section 1.03) (emphasis added). Allowing the Affiliates to provide input on such matters does not equate to an allocation of an employer right or obligation under RCW 82.04.540. This is especially true when the Agreement expressly states that Heartland "shall retain ultimate direction and control over such matters." CP at 38. As a whole, the Agreement allocates to Heartland the right to direct and control the employees with the Affiliates merely providing input on such matters.

Heartland takes issue with this interpretation of the Employee Leasing Agreement. Notwithstanding that the Agreement grants Heartland "ultimate direction and control" over certain matters, Heartland asserts that this does not divest the Affiliates of the employer rights and obligations that the Agreement allocated to them "in the first instance"

App. Br. at 10-11. In support of this theory, Heartland compares itself to the Washington Supreme Court with the "ultimate" right of review and the Affiliates to a trial court with the initial right of review. App. Br. at 11. The comparison is inapt.

The Washington Constitution expressly grants trial courts broad subject matter jurisdiction over all legal and equitable matters. Const. art. IV, § 6; *In re Marriage of Major*, 71 Wn. App. 531, 533, 859 P.2d 1262 (1993) (describing trial courts as having the power to hear and determine all cases, unless such power has been expressly denied by law). In contrast, the Employee Leasing Agreement does not expressly allocate "initial responsibility over employment duties" to the Affiliates as Heartland claims. App. Br. at 10. Instead, it grants this responsibility to Heartland alone, and it merely allows the Affiliates to "provide input" on such matters. CP at 37-38 (Section 1.03). Thus, unlike the Constitution's express grant of authority to trial courts, the Agreement fails to allocate any employer rights and obligations to the Affiliates.

b. This Court should not consider extrinsic evidence that contradicts the express language in the Employee Leasing Agreement.

Because the Employee Leasing Agreement's express language does not support its case, Heartland resorts to its course of dealing with the Affiliates in an effort to demonstrate that the Agreement satisfies RCW

82.04.540's allocation requirement. App. Br. at 12. This Court should reject Heartland's invitation to look beyond the four corners of the Agreement.

First, examining extrinsic evidence beyond the Employee Leasing Agreement is contrary to the legislative intent reflected in the plain language of RCW 82.04.540: the PEO deduction requires a written professional employer agreement providing for the coemployment of employees and allocating employer rights and obligations between a PEO and a client. Thus, a qualifying agreement must establish a coemployment relationship and allocate employer rights and obligations *in writing*.

This requirement for a written professional employer agreement makes sense in light of the PEO deduction's history. Prior to RCW 82.04.540, which was enacted in 2006, no statutory deduction existed for PEOs on wage and benefit amounts they paid to employees on behalf of coemployer clients. Laws of 2006, ch. 301, § 1. Instead, PEOs seeking to exclude these amounts from their taxable gross income would argue that they made the payments as agents for another entity, and not based on their own liability as an employer. In other words, they claimed that the amounts merely "passed through" them and could be excluded from B&O tax because the amounts did not meet RCW 82.04.080's definition of the "gross income of the business."

The Department's interpretation of how handling funds solely in the capacity of an agent affects B&O tax liability is in WAC 458-20-111 (Rule 111). For amounts to be excluded from taxable gross income, Rule 111 sets forth a significant hurdle: a taxpayer must be acting solely in an agency capacity for a client when receiving funds from the client that are used to pay a third party. *Wash. Imaging Services*, 171 Wn.2d at 561-62; *City of Tacoma v. William Rogers Co., Inc.*, 148 Wn.2d 169, 178, 60 P.3d 79 (2003). To determine whether this standard is met, a court must examine not only the contract between the taxpayer and client, but also the facts surrounding the relationship of the taxpayer and the third party. *Wash. Imaging Services,* 171 Wn.2d at 563; *William Rogers Co.*, 148 Wn.2d at 177-81. If the taxpayer has any liability to pay the third party beyond that of an agent for the client, the amounts it receives from the client are taxable and not treated as simply passing through the taxpayer. *Wash. Imaging Services,* 171 Wn.2d at 565-67; *William Rogers Co.*, 148 Wn.2d at 178.

The PEO deduction represents a departure from the fact-intensive inquiry that courts must make when applying Rule 111's demanding conditions in the context of coemployment arrangements. In the PEO deduction, the Legislature also eliminated the need for a taxpayer to establish solely agent liability. Rather than requiring courts to examine

the circumstances of each particular case, RCW 82.04.540 sets forth two specific documentation requirements that a taxpayer must satisfy to receive the PEO deduction: (1) a written professional employer agreement and (2) written notice of coemployment received by employees. By imposing these conditions, the Legislature likely intended to avoid the very situation presented in this case: a taxpayer relying upon extrinsic evidence to contradict the language in its own contracts. Thus, considering evidence beyond Heartland's written Employee Leasing Agreement with the Affiliates would expand the deduction beyond what the Legislature intended. *See Group Health Coop. of Puget Sound, Inc. v. Wash. State Tax Comm'n,* 72 Wn.2d 422, 429, 433 P.2d 201 (1967) (must narrowly construe tax deductions); *Budget Rent-A-Car of Washington-Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174, 500 P.2d 764 (1972) (taxation is the rule, exemptions or deductions are the exception).

Examining extrinsic evidence would also be contrary to contract interpretation principles. When interpreting a contract, the Supreme Court has stated that a court's primary purpose is to give effect to "the parties' intent at the time they executed the contract." *Int'l Marine Underwriters v. ABCD Marine, LLC*, 179 Wn.2d 274, 282, 313 P.3d 395 (2013). To do so, a court should focus on "the objective manifestations of the agreement, rather than on the unexpressed subjective intent of the parties." *Hearst*

Commc'ns, Inc. v. Seattle Times Co., 154 Wn.2d 493, 503, 115 P.3d 262 (2005). Thus, a court may consider evidence beyond the contract, such as the parties' course of dealings, "to determine the meaning of *specific words and terms used*," but not to "show an intention independent of the instrument" or to "vary, contradict or modify the written word." *Id.* (internal quotations omitted).

Rather than heeding these rules, Heartland argues that the course of dealings between itself and the Affiliates confirms that the Employee Leasing Agreement grants the Affiliates "primary responsibility" over various employer obligations, including recruiting, hiring, training, supervising, terminating, and evaluating. App. Br. at 12-13. But that is not so. The Agreement merely allows the Affiliates to "provide input" to Heartland on such matters. CP at 37 (Section 1.03). Heartland may not use alleged course of dealings to contradict and vary the plain language of its own Agreement. The case that Heartland relies upon demonstrates this. App. Br. at 13 (citing *Thayer v. Brady*, 28 Wn.2d 767, 770, 184 P.2d 50 (1947)). In *Thayer*, the Court agreed to an interpretation of certain terms in the contract proposed by the parties to that contract only after it concluded that the terms were ambiguous. *Id.* at 779-70. Here, the Agreement's language is clear, and Heartland does not dispute this. Thus, there is no

need to look to extrinsic evidence to interpret the unambiguous terms of the Agreement.

Nonetheless, even if the Court were to consider extrinsic evidence, such evidence would support the Department's position, not Heartland's. Heartland's reporting to Employment Security confirms that it did not consider itself a PEO. Similar to the requirements for PEOs with respect to excise taxes, the Legislature has imposed specific requirements on PEOs and their clients when reporting wages and paying taxes to Employment Security for unemployment insurance. *See* RCW 50.04.298 (providing definition for PEOs similar to definition for PEOs in the tax statute); RCW 50.12.300 (requirements for PEOs and clients when reporting to Employment Security); WAC 192-300-210 (same).

Neither Heartland nor the Affiliates met these requirements. None of the Affiliates registered with Employment Security. CP at 153, 204; RCW 50.12.300(1) (requiring each PEO client to register separately with Employment Security); WAC 192-300-210(3) (same). Because the Affiliates were not separately registered, they did not pay unemployment insurance taxes based on their own individual tax rates. CP at 153-54, 204-05; RCW 50.12.300(6) (PEO client must use its own assigned tax rate) WAC 192-300-220(1) (PEO and each client must be assigned individual tax rate according to its own experience).

Heartland also did not comply with the obligations of a PEO in reporting to Employment Security. CP at 204-05. Heartland failed to register each of the Affiliates as its clients with Employment Security. CP at 204; RCW 50.12.300(2)-(4) (PEOs shall submit certain information regarding their clients to Employment Security); WAC 192-300-210(5) (same). Nor did Heartland file a power of attorney form with Employment Security to allow it to represent the Affiliates for unemployment insurance purposes. CP at 154, 204-05; RCW 50.12.300(5) (PEO must submit power of attorney or other evidence authorizing it to act on a client's behalf); WAC 192-300-210(4) (same). Finally, Heartland failed to ensure that each of the Affiliates separately registered with Employment Security to obtain their own tax rate. CP at 153, 204; RCW 50.12.300(1) (PEOs must ensure clients are registered with Employment Security); WAC 192-300-210(3) (same). Thus, Heartland reported wages and paid unemployment insurance taxes to Employment Security as the sole employer, not as a PEO. CP at 204-10, 215-36.

Heartland's decision to report wages and pay taxes to Employment Security as the sole employer, rather than a PEO, demonstrates that it did not consider itself to be a PEO. Despite its reporting to Employment Security, Heartland claimed it was a PEO to the Department. Heartland should not be able to have it both ways, asserting for purposes of

unemployment insurance to be the employer, but then, when doing so suits its needs, asserting to be a PEO for the purpose of qualifying for a B&O tax deduction.[5]

The Employee Leasing Agreement says what it means: Heartland is the employer with direction and control over all aspects of the personnel's employment. This Court should reject Heartland's invitation to look beyond the express language in the Employee Leasing Agreement to extrinsic evidence because doing so would be contrary to the Legislature's intent. To qualify for the PEO deduction, Heartland must comply with the express requirements of RCW 82.04.540. It has failed to do so here.

2. The Employee Leasing Agreement fails to establish the coemployment of the employees.

Heartland's focus on RCW 82.04.540's allocation requirement for a written professional employer agreement ignores the Employee Leasing Agreement's express language contradicting the existence of a

[5] Before the trial court, Heartland argued that its inconsistent reporting is irrelevant to whether it qualified for the PEO deduction because it simply "neglected to change its reporting practices" to Employment Security when the Legislature adopted specific reporting requirements for PEOs in 2007. CP at 526. While Heartland's excuse for its inconsistent reporting may have been plausible in 2008, or even 2009, it has now "neglected to change its reporting practices" to Employment Security for more than seven years after the Legislature passed these new PEO requirements. Thus, Heartland's inconsistent reporting to Employment Security plainly is not merely a matter of Heartland neglecting to comply with Washington unemployment insurance law. Instead, it confirms that Heartland reported to Employment Security as a sole employer because it does not view itself as a PEO.

coemployment relationship. Moreover, in addition to the *allocation* requirement, a written professional employer agreement must provide for the *coemployment* of employees. RCW 82.04.540(3)(e). A "coemployment relationship" is defined in part as one that "is intended to be an ongoing relationship rather than a temporary or project-specific one." RCW 82.04.540(3)(c).

In the trial court, Heartland ignored this portion of the definition for a "coemployment relationship," and therefore, failed to demonstrate that its Employee Leasing Agreement with the Affiliates established such a relationship. CP 237-48. On appeal, Heartland again errs in disregarding the plain language of RCW 82.04.540. *See HomeStreet, Inc. v. Dep't of Revenue*, 166 Wn.2d 444, 451, 210 P.3d 297 (2009) (when a statute is unambiguous, courts must give effect to its plain language). Because the Employee Leasing Agreement does not provide for the coemployment of the employees with Heartland and the Affiliates, it is not a written professional employer agreement for purposes of the PEO deduction.

Rather than providing for the coemployment of the employees, the Employee Leasing Agreement expressly declares that Heartland alone is the employer: "All Personnel will be employees of [Heartland] . . . ." CP at 37 (Section 1.02). It explains that Heartland is the "provider of select personnel" necessary for the Affiliates. CP at 37. Further establishing that

Heartland is not a coemployer, nothing in the Agreement creates an "ongoing relationship" between the Affiliates and employees. *See* RCW 82.04.540(3)(c). Instead, the Agreement establishes the opposite, describing Heartland as the "provider of Personnel to each Lessee on a daily basis, as required." CP at 37 (Section 1.01). Similarly, the Agreement requires Heartland to "provide to each Lessee such Personnel as such Lessee shall deem necessary from time to time to operate such Lessee." CP at 37 (Section 1.01).

Heartland cannot explain how these provisions establish the coemployment relationship that RCW 82.04.540 specifically requires. Instead, Heartland simply ignores them and fails to even mention them in its brief. Heartland cannot avoid what its own Employee Leasing Agreement provides: Heartland alone is the employer that provides employees to the Affiliates as necessary "from time to time," or "on a daily basis as required." *See Hearst Commc'ns Inc.*, 154 Wn.2d at 504 (courts should "give words in a contract their ordinary, usual, and popular meaning").

In sum, rather than establishing a coemployment relationship between Heartland and the Affiliates, the Employee Leasing Agreement establishes Heartland as the employer of employees it provides to Affiliates, consistent with the name of the Agreement. As a matter of law,

the Agreement is not a "professional employer agreement" under RCW 82.04.540(3)(e), and for this reason alone, this Court should affirm the trial court's order granting summary judgment to the Department.

C. Heartland Fails the Second Element: Employees Do Not Receive Written Notice Of A Coemployment Relationship With Heartland And An Affiliate.

For Heartland to qualify as a PEO under RCW 82.04.540, the employees at issue also must have "received written notice of coemployment with the professional employer organization." RCW 82.04.540(3)(d)(i). As discussed above, a "coemployment relationship" is one that is "intended to be an ongoing relationship rather than a temporary or project-specific one, wherein the rights, duties, and obligations of an employer which arise out of an employment relationship have been allocated between coemployers pursuant to a professional employer agreement and applicable state law." RCW 82.04.540(3)(c). Thus, employees must receive written notice that they are in a coemployment relationship with Heartland and an Affiliate.

Heartland argues that "[i]t is undisputed that employees received abundant notice of their coemployment relationship with Heartland and the Clients – in a form specifically approved by DOR." App. Br. at 14. Heartland is mistaken. Not only does the Department dispute that employees received notice of their coemployment relationship, but both

the facts of the case and the Department's published tax advice refute Heartland's claim. None of the documents in the record that Heartland relies upon meet the standard of notice that RCW 82.04.540 requires. Accordingly, as a matter of law, Heartland cannot qualify for the PEO deduction because the employees did not receive notice of a coemployment relationship.

Heartland primarily relies upon two documents to assert that it meets RCW 82.04.540's notice requirement: an employee handbook and a paystub. App. Br. at 14-15. But these records, even when considered together, fail to provide employees with written notice of coemployment. The employee handbook expressly states, "Most employees are employed by Heartland Employment Services, LLC an employment company of HCR ManorCare." CP at 123. Heartland quotes this language in support of its own argument, but fails to acknowledge its unequivocal meaning. App. Br. at 14. The statement should be read to mean what it plainly says: most employees are employed by Heartland. Nothing in this language demonstrates that employees received notice of a coemployment relationship. At best, it may leave the employees to question whether they qualify as "most employees," and if not, how to identify their employer.

Rather than notifying employees of a coemployment relationship, the rest of the employee handbook raises additional questions for

employees. The handbook continuously references HCR ManorCare, rather than Heartland or a specific Affiliate. *See, e.g.,* CP at 122, 128, 131, 137. This leaves employees to wonder what HCR ManorCare refers to, since Heartland attributes so many different meanings to the term. CP at 148 (newsletter explaining that "HCR ManorCare employees" means employees of Heartland); 34 (Heartland's Vice President Kathryn Hoops testifying that HCR ManorCare refers to Heartland, the Affiliates, and all related companies); 627 (Ms. Hoops describing HCR ManorCare as a "trade name used by the operating affiliates of HCR ManorCare, Inc."). Thus, an employee handbook that states "most employees are employed by Heartland" and constantly references HCR ManorCare, as a matter of law, does not provide employees with notice of a coemployment relationship.

Because the employee handbook is insufficient, Heartland further asserts that the handbook, along with an employee's paystub, qualify as written notice of coemployment. App. Br. at 14-15. The paystubs, however, simply contain the name of Heartland, an Affiliate, and HCR ManorCare. CP at 149-50. Thus, the paystubs did nothing to notify employees of a coemployment relationship. Three names on a paystub combined with the express statement that employees are employed by Heartland surely cannot qualify as notice of coemployment.

As it did before the trial court, Heartland selectively quotes a portion of the Department's Excise Tax Advisory (ETA) interpreting RCW 82.04.540 to argue otherwise. App. Br. 14-15. According to Heartland, the ETA merely requires a PEO to be "listed in the employee handbook," and the paystub to contain the PEO's name. App. Br. at 14 (citing ETA 3192.2014 at 4). This is not what the ETA says.

In the ETA, the Department explains the notice requirement in RCW 82.04.540: "Although there is no specific language required, the notice must clearly identify the PEO and the client. Further it must put the individual employee on notice, either actual or constructive, that the employee is co-employed by both the PEO and the client." CP at 282 (ETA 3192.2014 at 3). The Department then provides an example of what it considers to be sufficient notice, a "PEO is listed in the employee handbook *as a PEO (or is adequately described as operating like a PEO)* and the employee's paystubs contain PEO's name." CP at 283 (ETA 3192.2014 at 4) (emphasis added). Thus, contrary to Heartland's argument, the Department's ETA does not interpret RCW 82.04.540 as merely requiring a PEO to be "listed in the employee handbook." Instead,

it expressly requires an employee handbook to list the PEO *as a PEO* or to describe it *as operating like a PEO.*[6]

Heartland does not come close to meeting the Department's example in the ETA. Its employee handbook does not list Heartland as a PEO or describe it as operating like one. Instead, it expressly states that "[m]ost employees are employed by Heartland." CP at 123. While the paystub contains Heartland's name, it also contains the name of the Affiliates and HCR ManorCare. CP at 149-50. Under both the statute and the Department's ETA, Heartland fails to meet RCW 82.04.540's notice requirement.

Because the employee handbook and paystub are insufficient, Heartland points to two other documents that it asserts meet RCW 82.04.540's notice requirement. App. Br. at 15. Heartland first relies upon a "Letter of Understanding" that employees receive when they begin their

---

[6] Before the trial court, the Department submitted two documents that Department Tax Policy Specialist Travis Yonkers considered to be examples of sufficient coemployment notice under RCW 82.04.540. CP at 600-06. Heartland complains that the trial court erred by failing to strike this evidence because the notices were not authenticated and "had nothing to do with Heartland and the Clients." App. Br. at 13, n.3. Heartland is wrong. Mr. Yonkers authenticated the documents in his declaration by explaining that he discovered them through Internet research on PEOs for Heartland's administrative appeal, and treated them as examples of sufficient coemployment notice. CP at 600-01; *See Int'l Ultimate, Inc. v. St. Paul Fire & Marine Ins. Co.*, 122 Wn. App. 736, 746, 87 P.3d 774 (2004) (authentication is meant to ensure that evidence is what is purports to be). Moreover, the trial court specifically stated that the material did not affect its ruling and was dicta. RP at 33 (April 8, 2016). Thus, even if the trial court erred by admitting this evidence, the error was harmless because the court did not rely upon the evidence when making its decision. *See Grey v. Leach*, 158 Wn. App. 837, 853, 244 P.3d 970 (2010) ("Only erroneous evidentiary rulings resulting in prejudice warrant reversal.").

employment. App. Br. at 15. But once again, Heartland fails to include all the relevant language from that letter. App. Br. at 15. The letter states, "I understand that as an employee of _____ (location name), I am working under the 40 hour work week as described in the Fair Labor Standard Act (Part 778) and as defined in the HCR ManorCare overtime policy." CP at 388. In the next paragraph, the letter declares that the individual "is an employee of HCR ManorCare" and states that "HCR ManorCare, through its employment company, Heartland Employment Services, LLC, is committed to paying its employees correctly and on-time." CP at 388. Thus, in its entirety, the "Letter of Understanding" is not notice to an employee of a coemployment relationship. It identifies Heartland as an employment company and refers to individuals as employees of a specific location and HCR ManorCare.

The next document that Heartland relies upon for satisfying RCW 82.04.540's notice requirement is a California Workers' Compensation notice posted on its Intranet. App. Br. at 15. As it did before the trial court, Heartland asserts that this record identifies Heartland as a PEO. App. Br. at 15. That is incorrect. The notice identifies Heartland as the hiring employer. CP at 393. It then responds "Yes" to the question, "Is hiring employer a staffing agency/business (e.g., Temporary Services Agency; Employee Leasing Company; or Professional Employer Organization

[PEO])?" CP 393. The notice also references another entity, HCR ManorCare, LLC, as the insurance carrier for workers' compensation. CP at 394. Thus, rather than identifying Heartland as a PEO, the notice refers to Heartland as the hiring employer, lists three different types of entities that Heartland could possibly be, and names HCR ManorCare, LLC as the insurance carrier. This does not constitute notice of coemployment.

Moreover, no evidence in the record establishes that the employees in Washington, as required by RCW 82.04.540, "received" the California notice. As Heartland itself describes it, the notice is made available to all employees on the Intranet. App. Br. at 15; CP at 393-94. Thus, this Court would have to assume facts not in evidence to conclude that employees "received" the notice, particularly given that this case involves Washington employees and the notice relates to California workers' compensation insurance laws.

Heartland points to "myriad forms of notice" in an effort to support its argument. App. Br. at 15. But none of these documents satisfy RCW 82.04.540's notice requirements. The employees did not receive notice of a coemployment relationship. Instead, they received multiple documents stating that Heartland is their employer, or referencing other entities without describing the relationship of the entities to the employees. Because the employees did not receive written notice of their

coemployment with a PEO as required in RCW 82.04.540(3)(d)(i), this is an additional reason that Heartland fails to qualify for the PEO deduction.

V. CONCLUSION

The language in RCW 82.04.540 is plain: to qualify for the PEO deduction, a taxpayer must have a written professional employer agreement and employees must receive written notice of coemployment. As a matter of law, Heartland does not meet either of these requirements. Accordingly, this Court should affirm the trial court's order granting summary judgment to the Department and denying summary judgment to Heartland.

RESPECTFULLY SUBMITTED this 31st day of October, 2016.

ROBERT W. FERGUSON
Attorney General

KELLY OWINGS, WSBA No. 44665
Assistant Attorney General
CAMERON G. COMFORT, WSBA No. 15188
Senior Assistant Attorney General
Attorneys for Respondent
State of Washington, Department of Revenue

PROOF OF SERVICE

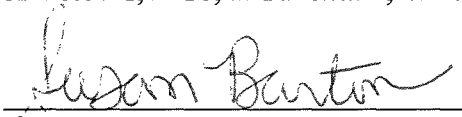
I certify that I served a copy of this document, via electronic mail, per agreement, on the following:

Scott Edwards
Lane Powell PC
1420 Fifth Avenue, Suite 4100
Seattle, WA 98101-2338
edwardss@lanepowell.com

Daniel Kittle
Lane Powell PC
1420 Fifth Avenue, Suite 4100
Seattle, WA 98101-2338
kittled@lanepowell.com

I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 31st day of October, 2016, at Tumwater, WA.



Susan Barton, Legal Assistant

APPENDIX A

EMPLOYEE LEASING AGREEMENT

This Employee Leasing Agreement (the "Agreement") is effective as of the 1st day of May, 2011 (the "Effective Date") by and between HEARTLAND EMPLOYMENT SERVICES, LLC, an Ohio limited liability company ("HES"), and each of the entities listed on Schedule 1 hereto (each a "Lessee").

STATEMENT OF FACTS:

WHEREAS, each Lessee is a subsidiary or affiliate of Manor Care, Inc., a Delaware corporation ("Manor Care");

WHEREAS, [Manor Care] and its subsidiaries and affiliates are providers of health care services, including skilled nursing care, assisted living care, subacute medical and rehabilitation therapy, home health care, hospice care, and management services for subacute care and rehabilitation therapy;

WHEREAS, the parties desire that HES be a provider of select personnel (the "Personnel") necessary to operate each Lessee in accordance with such Lessee's employee policies; and

WHEREAS, as of the Effective Date, the parties agree that this Agreement will supersede any and all prior agreements under which HES provided employee services to any Lessee.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, it is mutually covenanted and agreed by and between the parties hereto as follows:

ARTICLE I
APPOINTMENT OF DUTIES

Section 1.01 Appointment of HES. HES shall, during the term of this Agreement, be a provider of Personnel to each Lessee on a daily basis, as required. HES shall provide to each Lessee such Personnel as such Lessee shall deem necessary from time to time to operate such Lessee.

Section 1.02 Direction and Control of Personnel. HES shall have the right and responsibility to direct and control the Personnel consistent with each Lessee's employee policies, which any Lessee may amend from time to time at its sole discretion. All Personnel will be employees of HES and each Lessee will compensate HES for all appropriate Personnel expenses as required under this Agreement.

Section 1.03 Employment Policies. Each Lessee, as it deems necessary, shall have the right to provide input in recruiting, hiring, evaluating, replacing and supervising Personnel provided by

HES; provided, however, that HES shall retain ultimate direction and control over such matters. Each Lessee shall cooperate with HES in the formation and implementation of policies pertaining to the time and performance of duties by the Personnel. HES shall maintain the right of control and direction of the promulgation and administration of the Personnel employment policies.

Section 1.04 Compliance with Laws. HES shall comply with all federal, state and local employment laws and regulations, including, but not limited to, the Rehabilitation Act, the Americans with Disabilities Act, Title VII of the Civil Rights Act, the Age Discrimination in Employment Act and the Fair Labor Standards Act.

Section 1.05 Employment Taxes. HES shall be responsible for the payment of all federal and state employment taxes with respect to the Personnel payable by an employer and for the collection and remission to the appropriate taxing authority of all federal and state taxes to be withheld from the Personnel's wages.

Section 1.06 Workers Compensation Insurance. HES shall carry or provide through self-insurance all appropriate workers' compensation insurance with respect to the Personnel as may be required by law.

Section 1.07 Unemployment Compensation. HES shall be the rated employer for unemployment compensation purposes with respect to the Personnel.

Section 1.08 Limitation on Provision of Services. HES shall not provide any of the services contemplated in this Agreement to any third party competitor of any Lessee, a list of which shall be agreed to by and between the parties.

ARTICLE II
TERM

Section 2.01 Term. This Agreement shall remain in effect for a period of 10 years, commencing as of the Effective Date and expiring on April 30, 2021, unless terminated earlier as provided in Section 2.02.

Section 2.02 Termination. This Agreement may be partially terminated with respect to any individual Lessee without cause at any time by either HES or such Lessee upon 30 days' prior written notice to the other party or at any time upon agreement of HES and such Lessee; provided, however, with respect to any such partial termination, this Agreement shall remain unaltered and in full force and effect as to all remaining Lessee. This Agreement may be terminated with respect to all Lessees at any time by HES upon 30 days' prior written notice to all of the Lessees or at any time upon agreement of HES and all of the Lessees.

ARTICLE III
COMPENSATION

Section 3.01 Fees. In consideration of the aforementioned services, each Lessee shall pay an amount equal to the direct wage and compensation expenses incurred by HES to provide the services of the Personnel to such Lessee (the "Fee"). Such HES expenses shall include all wages, salaries, bonuses, employer payroll taxes, employee benefit costs, administration expenses, and overhead expenses (excluding any interest income or expense) relating to the Personnel, and the Fee shall be paid by each Lessee as such expenses are incurred.

Section 3.02 Record Keeping. HES agrees to maintain records, the adequacy and sufficiency of which will enable each Lessee to allocate the cost of service provided pursuant to this Agreement to the business units for which HES provides the Personnel.

Section 3.03 Adjustments. Any adjustment to HES's direct wage and compensation expenses associated with the Personnel shall result in an adjustment in the consideration payable to HES hereunder, payable no later than sixty (60) days after the end of the calendar year during which the expenses were incurred.

ARTICLE IV
COMPENSATION DISPUTES

Section 4.01 Dispute as to Fees. Either HES or any Lessee shall give written notice to the other party regarding any dispute as to the amount of the Fee pertaining to such Lessee for any calendar year within ninety (90) days of the issuance of the year-end financial statements of such Lessee for such year, or be forever barred from disputing such amounts.

ARTICLE V
REMEDIES

Section 5.01 Remedies. In addition to the remedies specifically set forth herein, the parties shall have all remedies otherwise available to them at law or in equity. The remedies herein provided shall be cumulative, and the exercise of any one remedy shall not preclude the non-defaulting party from exercising any other remedy available to it.

ARTICLE VI
ASSIGNABILITY

Section 6.01 Assignability. This Agreement, or any rights and privileges hereunder, shall not be assigned by HES without the written consent of the Lessees. This Agreement, or any rights and privileges hereunder, shall not be assigned by any Lessee without the written consent of HES.

ARTICLE VII
MISCELLANEOUS

Section 7.01 Governing Law. This Agreement and the performance hereof will be construed and governed in accordance with the laws of the State of Ohio, without regard to its choice of law principles.

Section 7.02 Amendments. This Agreement shall not be modified or amended without the written consent of HES. This Agreement may be modified or amended at any time by HES without the consent of an individual Lessee, so long as such Lessee's rights and obligations are not materially affected. If any modification or amendment materially affects the rights or obligations of an individual Lessee, such affected Lessee must consent in writing to such modification or amendment.

Section 7.03 Binding Effect. This Agreement shall be binding upon, and inure to the benefit of, the parties, and their respective successors and permitted assigns. Nothing in this Agreement, expressed or implied, is intended to confer on any person, other than the parties or their respective successors and permitted assigns, any rights, remedies, or liabilities under this Agreement.

Section 7.04 Entirety of Agreement. This Agreement contains the entire understanding of the parties, supersedes all prior agreements and understandings relating to the subject matter hereof and may not be amended except by a written instrument hereafter signed by each of the parties hereto.

Section 7.05 Liability. No Lessee shall be liable for the obligations under this Agreement of any other Lessee. Any liability of any Lessee under this Agreement shall be several and not joint.

Section 7.06 Exercise of Rights. No delay or omission by either party hereto in exercising any right, power or privilege hereunder will impair such right, power or privilege, nor will any single or partial exercise of any such right, power or privilege preclude any further exercise thereof or the exercise of any other right, power or privilege.

Section 7.07 Severability. If any provision of this Agreement is held to be illegal, invalid or unenforceable, such provision will be fully severable and this Agreement will be construed and enforced as if such illegal, invalid or unenforceable provision never comprised a part hereof; and the remaining provisions hereof will remain in full force and effect and will not be affected by the illegal, invalid or unenforceable provision or by its severance herefrom. Furthermore, in lieu of such illegal, invalid or unenforceable provision, there will be added automatically as part of this Agreement a provision as similar in its terms to such illegal, invalid or unenforceable provision as may be possible and be legal, valid and enforceable.

[*signature pages follows*]

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed by their duly authorized officers to be effective as of the Effective Date specified above.

HEARTLAND EMPLOYMENT SERVICES, LLC

By: _____
Name: Richard A. Parr II
Title: Vice President

The remaining signature pages of the Affiliates have been omitted, but they can be made available upon request.

APPENDIX B

RCW 82.04.540

Professional employer organizations—Taxable under RCW 82.04.290(2) —Deduction.

(1) The provision of professional employer services by a professional employer organization is taxable under RCW **82.04.290**(2).

(2) A professional employer organization is allowed a deduction from the gross income of the business derived from performing professional employer services that is equal to the portion of the fee charged to a client that represents the actual cost of wages and salaries, benefits, workers' compensation, payroll taxes, withholding, or other assessments paid to or on behalf of a covered employee by the professional employer organization under a professional employer agreement.

(3) For the purposes of this section, the following definitions apply:

(a) "Client" means any person who enters into a professional employer agreement with a professional employer organization. For purposes of this subsection (3)(a), "person" has the same meaning as "buyer" in RCW **82.08.010**.

(b) "Coemployer" means either a professional employer organization or a client.

(c) "Coemployment relationship" means a relationship which is intended to be an ongoing relationship rather than a temporary or project-specific one, wherein the rights, duties, and obligations of an employer which arise out of an employment relationship have been allocated between coemployers pursuant to a professional employer agreement and applicable state law. In such a coemployment relationship:

(i) The professional employer organization is entitled to enforce only such employer rights and is subject to only those obligations specifically allocated to the professional employer organization by the professional employer agreement or applicable state law;

(ii) The client is entitled to enforce those rights and obligated to provide and perform those employer obligations allocated to such client by the professional employer agreement and applicable state law; and

(iii) The client is entitled to enforce any right and obligated to perform any obligation of an employer not specifically allocated to the professional employer organization by the professional employer agreement or applicable state law.

(d) "Covered employee" means an individual having a coemployment relationship with a professional employer organization and a client who meets all of the following criteria: (i) The individual has received written notice of coemployment with the professional employer organization, and (ii) the individual's coemployment relationship is pursuant to a professional employer agreement. Individuals who are officers, directors, shareholders, partners, and managers of the client are covered employees to the extent the professional employer organization and the client have expressly agreed in the professional employer agreement that such individuals would be covered employees and provided such individuals meet the criteria of this subsection and act as operational managers or perform day-to-day operational services for the client.

(e) "Professional employer agreement" means a written contract by and between a client and a professional employer organization that provides:

(i) For the coemployment of covered employees; and

(ii) For the allocation of employer rights and obligations between the client and the professional employer organization with respect to the covered employees.

(f) "Professional employer organization" means any person engaged in the business of providing professional employer services. The following shall not be deemed to be professional employer organizations or the providing of professional employer services for purposes of this section:

(i) Arrangements wherein a person, whose principal business activity is not entering into professional employer arrangements and which does not hold itself out as a professional employer organization, shares employees with a commonly owned company within the meaning of section 414(b) and (c) of the Internal Revenue Code of 1986, as amended;

(ii) Independent contractor arrangements by which a person assumes responsibility for the product produced or service performed by such person or his or her agents and retains and exercises primary direction and control over the work performed by the individuals whose services are supplied under such arrangements; or

(iii) Providing staffing services.

(g) "Professional employer services" means the service of entering into a coemployment relationship with a client in which all or a majority of the employees providing services to a client or to a division or work unit of a client are covered employees.

(h) "Staffing services" means services consisting of a person:

(i) Recruiting and hiring its own employees;

(ii) Finding other organizations that need the services of those employees;

(iii) Assigning those employees on a temporary basis to perform work at or services for the other organizations to support or supplement the other organizations' workforces, or to provide assistance in special work situations such as, but not limited to, employee absences, skill shortages, seasonal workloads, or to perform special assignments or projects, all under the direction and supervision of the customer; and

(iv) Customarily attempting to reassign the employees to other organizations when they finish each assignment.

[2006 c 301 § 1.]

NOTES:

Effective date—Act does not affect application of Title 50 or 51 RCW—2006 c 301: See notes following RCW **82.32.710**.

WASHINGTON STATE ATTORNEY GENERAL

October 31, 2016 - 4:11 PM

Transmittal Letter

Document Uploaded: 4-488931-Respondent's Brief.pdf

Case Name: Heartland Employment Services v. State of WA, Dept. of Revenue
Court of Appeals Case Number: 48893-1

Is this a Personal Restraint Petition? Yes ■ No

The document being Filed is:

Designation of Clerk's Papers Supplemental Designation of Clerk's Papers

Statement of Arrangements

Motion: ____

Answer/Reply to Motion: ____

■ Brief: __Respondent's__

Statement of Additional Authorities

Cost Bill

Objection to Cost Bill

Affidavit

Letter

Copy of Verbatim Report of Proceedings - No. of Volumes: ____
Hearing Date(s): _____

Personal Restraint Petition (PRP)

Response to Personal Restraint Petition

Reply to Response to Personal Restraint Petition

Petition for Review (PRV)

Other: _____

Comments:

No Comments were entered.

Sender Name: Susan M Barton - Email: susanb5@atg.wa.gov

A copy of this document has been emailed to the following addresses:

susanb5@atg.wa.gov
KellyO2@atg.wa.gov